

## **Bankruptcy Bulletin**

*A Publication of the Minnesota State Bar Association Bankruptcy Section*  
**Winter 2013/2014**

### ***Editors-In-Chief:***

Mychal Bruggeman  
Dewitt Mackall, Crouse & Moore S.C.  
(612) 305-1400  
mab@dewittmcm.com

Edwin H. Caldie  
Leonard, Street and Deinard, P.A.  
(612) 335-1404  
ed.caldie@leonard.com

John D. Lamey III  
Lamey Law Firm, P.A.  
(651) 209-3550  
jlamey@lameylaw.com

### ***Editorial Board:***

James C. Brand  
Fredrikson & Byron, P.A.  
(612) 492-7408  
jbrand@fredlaw.com

Benjamin J. Court  
Messerli & Kramer, P.A.  
(612) 672-3709  
bcourt@messerlikramer.com

### ***Editorial Board (continued):***

Daniel M. Eaton  
Christensen Law Office, PLLC  
(612) 823-0188  
dan@clawoffice.com

Elizabeth Hulsebos  
Dorsey & Whitney, LLC  
(612) 492-6919  
hulsebos.elizabeth@dorsey.com

Sarah M. Olson  
Fredrikson & Byron, P.A.  
(612) 492-7452  
solson@fredlaw.com

Amanda Schlitz  
Leonard Street Deinard, P.A.  
(612) 335-1943  
Amanda.Schlitz@leonard.com

Kesha Tanabe  
ASK, LLP  
651-406-9665  
ktanabe@askllp.com

## IN THIS ISSUE

***Predicate Creditor Under Section 544(b)(1) Must Be Specifically Identified In The Complaint; Ponzi Scheme Presumption Applied***

***Rejected Chapter 13 Plan Fails To Comply With Local Rule 3012-1***

***Junior Lienholder Must Hold A Secured Claim Under Section 506(a) To Qualify For The Anti-Modification Protection Under Section 1322(b)(2)***

***Sanctions Upheld For Failing To Turn Over Documents And For Making Sensational Accusations***

***Defalcation Requires Intentional Wrongdoing Or Willful Disregard Of Fiduciary Duties***

***Student Loans Must Be Reviewed Individually For Undue Hardship Determination***

***Defendant Seeking Review Of The Applicability Of The Ponzi Scheme Presumption Denied Direct Appeal To Eighth Circuit***

***Future Payments Under Alimony Award Can Be Property Of The Estate Depending On State Law***

***Full Faith and Credit Statute Prevents Relitigation Of Prior State Court Judgment Barring Creditor's Claim***

***Debtor's Loan Repayment Was Not Contemporaneous Value And First-Time Lending Activity Was Not Ordinary***

***The Government Was Entitled To Conduct Discovery And An Evidentiary Hearing On Its Superpriority Unsecured Claim***

***Claim for Conversion Nondischargeable under Section 523(a)(4) When Debtor Cashed Insurance Checks Without the Endorsement of the Co-Payee***

***A Health Savings Account Is Not An Excluded Asset Under Section 541(b)(7)***

***A Pro Se Chapter 11 Debtor May Not Make An Early Paydown Of Professional Fees***

***Remand Required Where Equipment Malfunction Resulted In No Transcript Of Bankruptcy Court Hearing***

***Six Days' Notice Prior To Discharge Insufficient To Bar Creditor's Nondischargeability Claim***

***Relation Back Of Claims In Amended Complaint Permitted Even If Plaintiff Was To***

***Blame For Not Identifying The Proper Party; Preference Defenses Not Established By Settlement Agreement To Which Debtor Was Not A Party***

***Obligation To Fund Retiree Benefits Contained In CBA May Survive Rejection Of CBA Depending On Terms Of Modification Under Section 1114***

***Petitioning Creditor Entitled To Recover Only Fees And Expenses Actually and Necessarily Incurred; Reimbursement For Salaried Employees By The Petitioning Creditor Disallowed***

***Nationally Chartered Bank May Use State Statutory Non-Judicial Foreclosure Remedies Without Receiving Authorization To Do Business In The State Through Registration With A Formal State Agency***

***Post-Petition Judgment Registration Survives Avoidance Action; Mortgagee that Slept on its Rights Lacks Standing to Assert Stay Violation***

***Appeal Dismissed for Failure to Comply with the Federal Rules of Bankruptcy Procedure***

**Editors Note\*All Statutory References Herein are to Title 11, U.S. Code, Unless Noted Otherwise**

---

***Predicate Creditor Under Section 544(b)(1) Must Be Specifically Identified In The Complaint; Ponzi Scheme Presumption Applied***

In *In re Petters Co.*, 495 B.R. 887 (Bankr. D. Minn. 2013), the bankruptcy court held that a fraudulent transfer complaint based on state law must specifically name a creditor who has standing to avoid transfers under state law for the trustee to have standing under Section 544(B)(1). Further, the existence of a Ponzi scheme can also establish that transfers in furtherance of the scheme were made with the intent to hinder, delay, and defraud future and existing creditors of the purveyor.

The trustee brought over two hundred adversary proceedings to recover payments allegedly made in connection with a Ponzi scheme. The bankruptcy court, faced with numerous motions to dismiss, has issued a series of memoranda to address common issues among the adversaries. This summary addresses the second memorandum, issued on July 12, 2013 and amended August 30, 2013, which addressed issues of standing, the statute of limitations, and sufficiency of pleading a fraudulent transfer claim.

The court held that to have standing under Minnesota's fraudulent transfer law pursuant to Section 544(b)(1), the trustee must identify a specific unsecured creditor (the "predicate creditor") who

had the right to bring the fraudulent transfer action as of the petition date. The concept of a specific predicate creditor is especially important in the context of the statute of limitation, because the “discovery rule” to extend the statute of limitations only applies if the predicate creditor did not discover the fraud until within six years before the petition date. Indeed, to survive a motion to dismiss, the complaint must allege the specific facts that prevented the predicate creditor from discovering the fraud.

The court also held that a presumption of fraud arises if the challenged transfer occurred in the context of a Ponzi scheme. As a result, a trustee may adequately allege “actual fraud” by pleading that the challenged transfer was in furtherance of the Ponzi scheme or by identifying badges of fraud. This presumption eases the trustee’s burden significantly, as Fed. R. Civ. P. 9(b) generally requires actually fraudulent transfers to be pled with particularity.

As a result of these rulings, the trustee was required to amend the complaints to identify the applicable predicate creditor(s), but much of the remaining allegations satisfied the pleading standards.

### ***Rejected Chapter 13 Plan Fails To Comply With Local Rule 3012-1***

In *In re Jacobson*, 12-37183, (Bankr. D. Minn.), the court rejected a Chapter 13 lien stripping plan. The debtors failed to provide any evidence of their home’s value in support of their proposed plan, and they also failed to comply with the service requirements for lien-stripping set forth in the new Local Rule 3012-1.

The court refused to confirm the proposed plan due to the concerns regarding “due process and real estate title that prompted the recent (and lengthy) local project toward the promulgation of new Local Rule 3012-1.” The court ordered the debtors to comply fully with Local Rule 3012-1 before the occurrence of a second confirmation hearing set for a later date.

### ***Junior Lienholder Must Hold A Secured Claim Under Section 506(a) To Qualify For The Anti-Modification Protection Under Section 1322(b)(2)***

In *Minnesota Housing Finance Agency v. Schmidt*, 13-434, (D. Minn.), the district court affirmed the bankruptcy court’s confirmation of a chapter 13 lien stripping plan.

The debtors filed a motion in the underlying bankruptcy seeking: (i) a determination that there was no equity in their home to support a junior lien; (ii) reclassification of the lender’s claim from secured to unsecured; and (iii) avoidance of the lender’s lien upon the successful completion of their proposed chapter 13 plan. The bankruptcy court granted the debtors’ motion and confirmed the proposed plan over the lender’s objection.

On appeal, the lender acknowledged that the collateral-property was not worth more than the amount of the first lien encumbering it, but argued that Section 1322(b)(2) prevented the debtors from modifying its claim or removing its junior lien because Section 1322(b)(2) did not impose a valuation test as a condition for protection.

After considering the relevant case law, legislative history, and statutory and policy considerations, the district court rejected the lender's arguments, concluding that a residential mortgagee must hold a secured claim under Section 506(a) to qualify for protection under the anti-modification provision of Section 1322(b)(2). This decision is under consideration at the Eighth Circuit Court of Appeals, and follows the *Fisette* case which had been dismissed at the Eighth Circuit for lack of proper appellate jurisdiction.

### ***Sanctions Upheld For Failing To Turn Over Documents And For Making Sensational Accusations***

In *Isaacson v. Manty*, 12-2384, (8th Cir.), the court denied relief to appellant who sought to vacate sanctions imposed by the bankruptcy court.

A discovery dispute arose between the debtor and the trustee appointed to administer its estate. Upon considering the dispute, the bankruptcy court entered an order requiring the debtor to turn over documents, and threatening sanctions for non-compliance. The debtor failed to comply, and the trustee sought a contempt order against the debtor's principal. The bankruptcy court ordered the principal to personally appear at the contempt hearing.

Prior to the hearing, the principal filed an inflammatory memorandum which included sensational language and unfounded allegations against the court, the trustee, and counsel for the U.S. Trustee.

The principal did not appear at the

contempt hearing, and the bankruptcy court entered a contempt order. The principal could purge the contempt by appearing at a second hearing. The bankruptcy court also entered an order *sua sponte* requiring the principal and her attorney to show cause why sanctions should not be imposed for her outrageous and unfounded allegations. In response, the principal filed a second inflammatory memorandum and again failed to appear at the related hearing.

The bankruptcy judge held that the principal violated Federal Rule of Bankruptcy Procedure 9011(b)(1) and (3), and imposed a \$500 sanction per "outrageous" statement in her first memorandum, for a total penalty of \$5,000. The district court affirmed the bankruptcy court's decision, and the principal appealed to the Eighth Circuit Court of Appeals, arguing that (i) the \$5,000 penalty constituted a criminal penalty; (ii) criminal sanctions proceedings require heightened procedural protections that were not employed in this case; and (iii) the bankruptcy court abused its discretion in determining the amount of the monetary sanctions.

The Eighth Circuit held that although Federal Rule of Bankruptcy Procedure 9011 did not authorize the sanctions at issue, the bankruptcy court nevertheless had authority to impose sanctions. The Eighth Circuit also held that no other procedural or substantive argument asserted warranted reversal, and affirmed the decisions of the lower courts.

### ***Defalcation Requires Intentional Wrongdoing Or Willful Disregard Of Fiduciary Duties***

In *Bullock v. Bankchampaign, N.A.*, 133 S.Ct. 1754, the Supreme Court held that a debt is non-dischargeable under Section 523(a)(4) for defalcation while the debtor was acting in a fiduciary capacity only if the fiduciary acted with intentional wrongdoing or in willful disregard of its duties. Until now, circuits were split on whether “defalcation”, like fraud, embezzlement or larceny, required any particular state of mind.

In *Bullock*, debtor was the trustee of a family trust. The sole asset of the trust was an insurance policy. On three occasions the debtor borrowed money against the policy, as permitted by the insurance company. The debtor fully repaid the loans but earned personal profits from the transactions which far exceeded the interest paid to the trust on account of his borrowing. The trust beneficiaries sued and obtained a judgment against the debtor for self-dealing. All parties agree that the debtor did not know his actions were unlawful, and the lower court did not find any malicious intent. However, the lower court held that the debtor’s actions as trustee constituted a breach of his fiduciary duties under Illinois law. In the debtor’s bankruptcy, the beneficiaries commenced sought to except their judgment against the debtor from discharge under Section 523(a)(4).

The *Bullock* Court reversed and vacated an Eleventh Circuit decision that held petitioner’s debt was non-dischargeable under Section 523(a)(4), and remanded for a determination of whether the debtor intentionally breached or willfully

disregarded his fiduciary duties.

### ***Student Loans Must Be Reviewed Individually For Undue Hardship Determination***

In *Conway v. National Collegiate Trust (in re Conway)*, 13-6016 (8th Cir. BAP), the court reversed a bankruptcy court’s determination that a debtor’s student loans were non-dischargeable under Section 523(a)(8). Under Section 523(a)(8), student loan obligations are non-dischargeable unless a debtor seeks and obtains a hardship determination from the bankruptcy court where the debtor must show by a preponderance of evidence that its student loan debt would impose an “undue hardship” on the debtor if it was excepted from discharge. In the Eighth Circuit, such determination is made by a “totality of circumstances” test based on three factors: (1) debtor’s earning potential; (2) debtor’s reasonable and necessary living expenses; and (3) any other facts and circumstances related to the hardship inquiry.

*Conway* found that courts must also review each student loan individually, rather than considering hardship based upon the debtor’s aggregate amount of student loan debt. In *Conway*, the bankruptcy court considered undue hardship based on a total of \$118,580 owed on fifteen student loans. The BAP reversed and remanded, instructing the bankruptcy court to apply the hardship analysis to each loan individually. The BAP also instructed that Section 523(a)(8) does not permit “partial discharge” of student loans, or any other “judicial revision” of the terms of debtor’s student loans.

***Defendant Seeking Review Of The Applicability Of The Ponzi Scheme Presumption Denied Direct Appeal To Eighth Circuit***

In *Ritchie Capital Management, LLC v. Stoebner (in re Polaroid)*, 12-3038 (D. Minn.), the district court denied an avoidance action defendant's motion to certify a direct appeal to the Eighth Circuit of an important 2012 ruling where the bankruptcy court granted summary judgment and avoided transfers made in furtherance of the Petters Ponzi scheme as actually fraudulent. The bankruptcy court's primary basis of reasoning to support its decision relied on applying the Ponzi scheme presumption, which had not previously been recognized in this district or by the Eighth Circuit Court of Appeals.

Section 158(d)(2)(A)(i) of the Judicial Code (28 U.S.C. §) permits a direct appeal if the district court certifies that the appeal presents a question of law as to which there is no controlling decision. Section 158(d) further permits such an appeal if it would materially advance the progress of the case.

The district court denied the motion. While the Eighth Circuit had not considered applicability of the Ponzi presumption, the motion failed because the bankruptcy court adopted the Ponzi presumption only as an alternate holding as it also found the transfers avoidable under the traditional badges of fraud. The district court also noted that the bankruptcy court ruling involved a mixed question of fact and law, which favored denying a request for direct appeal. Finally, the district court did not find that permitting the direct appeal would

materially advance the case.

***Future Payments Under Alimony Award Can Be Property Of The Estate Depending On State Law***

In *Mehlhoff v. Allred (In re Mehlhoff)*, No. 13-6012 (8th Cir. BAP), the court, applying South Dakota law, affirmed that a chapter 7 debtor's claim against her former spouse for alimony qualified as property of the estate under Section 541(a)(1).

The debtor scheduled a prepetition alimony award as an asset and income, but could not claim any portion of the alimony exempt based on South Dakota exemption law. Since South Dakota has opted out of bankruptcy code exemptions listed in 522(d), the trustee sought turnover of the alimony award. The bankruptcy court held that the future payments under the alimony award were property of the estate, and ordered turnover.

The BAP affirmed, concluding that Section 541(a)(1) is broad enough to include alimony, provided that such an award is considered to be an "interest in property" of the debtor under applicable state law.

The BAP examined South Dakota case law and found that it treats alimony as an interest in property. Thus, the debtor's future alimony payments were property of the estate, subject to any exemptions the debtor may have under state law, which here were unavailable.

***Full Faith And Credit Statute Prevents Relitigation Of Prior State Court Judgment Barring Creditor's Claim***

In *Cawley v. Celeste (In re Athens/Alpha Gas Corp.)*, 12-1555 (8th Cir.), the court applied the full faith and credit provision of the Judicial Code, 28 U.S.C. § 1738, to grant preclusive effect to a judgment of the North Dakota Supreme Court, thereby barring a creditor's claims in a re-opened bankruptcy case.

The chapter 11 debtor scheduled Cawley as a secured creditor with a security interest in a hydrocarbon well. A group of competing creditors challenged Cawley's secured status, Cawley failed to respond, and the bankruptcy court entered an order disallowing the Cawley's secured claim. Further, without any objection from Cawley, the court confirmed a chapter 11 plan which transferred the debtor's interest in Cawley's alleged collateral free and clear to a successor entity.

After plan confirmation, Cawley filed an action in North Dakota state court reasserting his interest in the well. The North Dakota Supreme Court barred his claims under *res judicata* after concluding that Cawley had full and fair opportunity to assert the claim in the bankruptcy.

Cawley then sought to have his claims determined by the bankruptcy court. The bankruptcy court credited the North Dakota Supreme Court and denied relief. On appeal, the BAP denied relief but held that the *Rooker-Feldman* doctrine applied, which prevented the bankruptcy court from even considering the ruling of the North Dakota Supreme Court. The Eighth Circuit, however, determined to bypass

this murky *Rooker-Feldman* inquiry and considered the preclusion issue.

In support of preclusion, the full faith and credit statute provides that a federal court must give a state court judgment the same preclusive effect it would be given by the law of the state in where judgment was rendered.

The Eighth Circuit applied the elements of *res judicata* under North Dakota law. One such element is a final decision on the merits by a court of competent jurisdiction. Cawley argued that North Dakota state court lacked jurisdiction, because 28 U.S.C. § 1334(e) grants federal courts exclusive jurisdiction over "property of the estate." The Eighth Circuit held a state court's judgment as to its own jurisdiction must be given full faith and credit if the issue was fully and fairly litigated and finally decided. The Eighth Court found that the issue had been fully and fairly litigated, and finally decided by, the North Dakota state courts, so the jurisdiction issue could not be revisited.

***Debtor's Loan Repayment Was Not Contemporaneous Value And First-Time Lending Activity Was Not Ordinary***

In *Ries v. Operation Bass, Inc., (In re Genmar Holdings, Inc.)*, Adv. No. 11-4715 (Bankr. D. Minn.), the court rejected defenses under Section 547(c)(1) and Section 547(c)(2) to the trustee's avoidable preference claims for lack of evidence of value and ordinariness in the transaction.

Debtor was in the business of manufacturing and selling recreational power boats. Related to this business, the

debtor sponsored the defendant's fishing tournaments. When the debtor became financially distressed, the defendant made six different loans to the debtor over the course of several months totaling approximately \$7.8 million. Of these six loans, two were memorialized in promissory notes; however, the other four loans were not. The debtor repaid \$5 million within the preference period.

The court denied the contemporary exchange defense under Section 547(c)(1) because the defendant failed to establish any provision of new value to the debtor, a required element to establish the defense. Certainly, the debtor paying \$5 million on antecedent is not new value to the debtor.

The court next denied the ordinary course of business defense under Section 547(c)(2) because: (1) the loans were not part of the normal conduct of business between the debtor and the defendant; (2) the defendant had never before made any loans to the debtor or anyone else; and (3) the terms of the notes, or lack thereof, were not those of ordinary loans.

***The Government Was Entitled To Conduct Discovery And An Evidentiary Hearing On Its Superpriority Unsecured Claim***

In *United States of America, Internal Revenue Service vs. Rick D. Lange, (In re Netal, Inc.)*, 13-6007 (8th Cir. BAP), the court reversed the bankruptcy court's denial of the United States' motion for approval of a superpriority unsecured claim under Section 507(b). The government sought approval of the claim after the chapter 7 case converted from chapter 11. At the time of the conversion,

there were insufficient funds available to pay all claimants.

Other priority claim holders objected to the government's motion, and also disputed, for the first time at the hearing, the amount of the government's claim. Having not been prepared to argue this issue, the government requested allowance to conduct discovery on the matter and hold an evidentiary hearing to resolve the dispute, should the court find there was such a factual dispute.

The bankruptcy court denied the government's motion for approval of a Section 507(b) claim on the basis that Section 724(b) governed its claim. The bankruptcy court further denied the government's request for an evidentiary hearing.

On appeal, the BAP reversed and held that the bankruptcy court abused its discretion. The bankruptcy court erred in holding that Section 724(b) applied to the government's claim. The BAP explained that Section 724(b) applies to secured claims arising from a lien, and not to unsecured superpriority claims under Section 507(b). After reaching this conclusion, the BAP applied Section 503(b)(1)(A) and Federal Rule of Bankruptcy Procedure 9014(a) which both require a hearing to determine the allowance of the asserted claim. The BAP ruled that the government could conduct discovery in anticipation of the hearing.

***Claim for Conversion Nondischargeable under Section 523(a)(4) When Debtor Cashed Insurance Checks Without the Endorsement of the Co-Payee***

In *Bank of America vs. Armstrong (in re Armstrong)*, 13-6013 (8th Cir. BAP), the BAP affirmed a non-dischargability ruling under Section 523(a)(4) against the debtor for conversion of a jointly-issued insurance check.

The debtor was the sole owner of RNA Properties, LLC, which acquired a strip mall through financing from Southwest Bank. The loan documents required RNA to list Southwest Bank as loss payee on its insurance policies. The insurer of the property listed Southwest as the mortgage holder, but not as the loss payee as the loan documents required.

A fire damaged the property and the insurer issued nine checks under the policy totaling \$917,149.26 made payable to the debtor, d/b/a RNA Properties, LLC. Three checks totaling \$135,500 were made payable to the debtor, d/b/a RNA Properties, LLC, and Southwest Bank, as co-payee. The debtor endorsed and deposited all three checks without the endorsement of Southwest Bank. The debtor then used less than \$5,000 to pay for repairs to the mall and diverted the remainder for personal use. Debtor did not disclose the fire to Southwest Bank.

Southwest Bank eventually became aware of the fire, declared default, and foreclosed. The insurer sued the debtor, RNA, and Southwest Bank. Southwest Bank joined Bank of America as a third party defendant for negotiating the unendorsed checks payable jointly to Southwest Bank. Southwest Bank and Bank of America settled for the amount of

the unendorsed checks and Bank of America subrogated to Southwest Bank's claims against the debtor and RNA.

The debtor filed for bankruptcy and Bank of America sought to except its claim from discharge under Sections 523(a)(2)(A) and (a)(4) for fraud and embezzlement. The bankruptcy court held in favor of Bank of America on both counts. On appeal, the BAP affirmed that the debt was nondischargeable under Section 523(a)(4) but declined to address whether debtor's conduct also provided grounds under Section 523(a)(2)(A).

The BAP affirmed that Bank of America had proper standing through subrogation. The BAP further held that debtor's conduct established a ground for exception for discharge under Section 523(a)(4) because while the debtor may have lawfully received the checks initially, his unlawful misappropriation constituted embezzlement. If the debtor had not obtained the funds legally, it would constitute a larceny, a separate but equal ground for non-discharge under Section 523(a)(4).

***A Health Savings Account Is Not An Excluded Asset Under Section 541(b)(7)***

In *Leitch v. Christians (In re Leitch)*, No. 13-6009, (B.A.P. 8th Cir.) the BAP rejected the debtor's exclusion of a Health Savings Account from the bankruptcy estate as an exempt state regulated health plan under Section 541(b)(7)(A)(ii), or under similar state exemption.

The debtor made deposits to his HSA through deductions from his paycheck, and received tax benefits for using this account for medical purposes. The

trustee objected to the exclusion of the HSA account and sought to include in the estate. The bankruptcy court sustained the objection and rejected the debtor's argument that an HSA was a state regulated health plan. The bankruptcy court further held that the HSA did not qualify under Minnesota state exemptions.

The BAP agreed with the bankruptcy court that an HSA was nothing more than a trust account, and that Section 541(b)(7)(A)(ii) and the state exemptions did not apply. The debtor had unrestricted access to the funds, and the HSA is not a state regulated health insurance plan just because the debtor receives tax benefits when using it for medical purposes. The BAP also relied on the fact that Congress created HSAs two years before enactment of Section 541(b)(7), and but did not expressly include HSAs within Section 541(b)(7).

### ***A Pro Se Chapter 11 Debtor May Not Make An Early Paydown Of Professional Fees***

In *In re Driggs*, 13-42355 (Bankr. D. Minn.), a *pro se* chapter 11 debtor filed an application for approval to hire an H & R Block employee to help him prepare his tax returns as required by the U.S. Trustee. The debtor requested authorization to make weekly payments to the H & R Block employee pursuant to Instruction 9(c) of the Chapter 11 Filing Instructions, known as "Paydown Before Approval." These instructions act as an accommodation to Sections 330 and 331, which state that no professional person employed by a debtor may be paid before an application for allowance is approved by the presiding judge.

The court found that the debtor was entitled to accommodation of an interval for fee applications, but that Instruction 9(c) does not create a right to an "early paydown" for the services of the H & R Block employee. The court further stated that it lacked discretion to allow the request because there was no attorney to exercise appropriate control over the debtor's use of professional services. Without a counsel monitoring whether the privilege under Instruction 9(c) is responsibly merited, the estate's interests were not properly safeguarded.

### ***Remand Required Where Equipment Malfunction Resulted In No Transcript Of Bankruptcy Court Hearing***

In *In re WEB2B Payment Solutions, Inc.*, 11-42325, (D. Minn.) the court was unable to review the transcript of the bankruptcy court's findings because of a malfunction in the bankruptcy court's audio equipment. The parties to the case also did not develop a statement of the record pursuant to Rules 10(d) and (e) of the Federal Rules of Appellate Procedure.

Federal Rule of Bankruptcy Procedure 8006 requires that an appellant provide the court with transcripts, which are essential to conducting a meaningful review. The court emphasized that when it is acting as an appellate court, it has no authority to make factual findings if the bankruptcy court is silent or ambiguous regarding a determinative fact. If there are no factual findings to be reviewed, courts have consistently held that remand is necessary.

### ***Six Days' Notice Prior To Discharge Insufficient To Bar Creditor's Nondischargeability Claim***

Even though the creditors had actual notice of the deadline to file dischargeability complaint just prior to the deadline, the court in *Hathorn v. Petty (In re Petty)*, 13-6002 (8th Cir. BAP), held that the plaintiffs' complaint could not be dismissed as untimely under Section 523(a)(3)(B).

Prior to the bankruptcy, plaintiffs commenced an action in state court against one of the debtors asserting intentional torts and other state law claims. The debtors listed the lawsuit in their statement of financial affairs as a pending legal proceeding, but did not schedule the plaintiffs as creditors or include plaintiffs in the matrix. Accordingly, the court did not mail plaintiffs the notice of the bankruptcy filing informing them of the upcoming deadline to object to the dischargeability of debts.

Approximately a month later, the debtors filed amended schedules and updated the matrix, but did not include the plaintiffs on these supplemental filings. After entry of discharge, the debtors further amended their schedules and listed the plaintiffs. Regardless, the plaintiffs obtained actual notice of the bankruptcy case, as well as a copy of the notice of the deadline for dischargeability complaints, six days before the deadline.

Fifty-eight days after the deadline and sixty-four days after having received notice, plaintiffs filed an adversary proceeding objecting to dischargeability of their claim. The bankruptcy court dismissed the complaint as untimely, but

the BAP reversed.

A self-effectuating exception to discharge is provided in Section 523(a)(3)(B) for debts that are neither listed nor scheduled in time to permit "if such debt is of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim and timely request for a determination of dischargeability of such debt . . . , unless such creditor had notice of actual knowledge of the case in time for such timely filing and request[.]" When examining the adequacy of notice under Section 523(a)(3), the court considers: (1) whether the debt is of a kind described in Section 523(a)(2), (4), or (6); (2) whether the debt was listed or scheduled; (3) whether the plaintiff had actual knowledge of the case in time to timely commence a nondischargeability action; and (4) whether the plaintiff's case has merit. In this case, the only consideration for the BAP was whether the plaintiffs had actual knowledge of the case in time to timely file their complaint.

While the bankruptcy court held that the plaintiffs should not be entitled to the Section 523(a)(3) exception from discharge because they failed to take timely action for sixty-four days after receiving notice of the deadline to file their complaint, the BAP observed that the bankruptcy court acknowledged that six days' notice was insufficient to object to discharge. Therefore, the BAP held that the bankruptcy court erred in granting the motion to dismiss, stating, "if a creditor with a debt of the kind specified in § 523(a)(2), (4), or (6) did not receive actual knowledge of the bankruptcy case in time for timely filing . . . , the inquiry ends there – the debt is not discharged." Accordingly, the BAP reversed and allowed plaintiffs to proceed with their

complaint to try to prove that they hold a debt of a kind described in Section 523(a)(6).

***Relation Back Of Claims In Amended Complaint Permitted Even If Plaintiff Was To Blame For Not Identifying The Proper Party; Preference Defenses Not Established By Settlement Agreement To Which Debtor Was Not A Party***

In *Ries v. Calandrillo (In re Genmar Holdings, Inc.)*, 13-6003 (8th Cir. BAP), the plaintiff's amendment to add a party it should have originally named could nonetheless "relate back" for bringing the claim within the statute of limitations. Further, settlement agreements not entered into by the debtor could not establish preference defenses.

The defendant had purchased a defective boat from the retailer. The defendant filed a statement of claim with the American Arbitration Association, naming the retailer and others as respondents, and later entered into a settlement agreement whereby he agreed to convey title to the boat to Genmar Tennessee, Inc., in exchange for payment from Hydra-Sports Boats. For reasons not apparent from the record, Genmar Holdings, Inc. made the settlement payment to defendant. The next month, Genmar Holdings, Inc. and 21 of its subsidiaries filed for bankruptcy.

The trustee commenced an adversary proceeding against the law firm that represented the defendant and was the recipient of the alleged preferential transfer. One day after the statute of limitations expired to file a preference complaint, the law firm informed the trustee that it was a mere conduit as it

received the payment on behalf of its client in connection with the settlement of the lawsuit. The trustee moved to amend his adversary complaint to include the defendant, and sought relation back of the amended claims. The bankruptcy court granted the Trustee's motion and the BAP affirmed.

An amendment that adds a party "relates back" to the original pleading where three requirements are satisfied: (1) the claims asserted against the new party arise out of the same conduct, transaction or occurrence set forth in the original pleading; (2) the new party received notice of the action within the period for service of the summons and complaint under Rule 4(m); and (3) the new party knew or should have known that, but for a mistake concerning the identity of the proper party, the action would have been commenced against it.

Defendant did not argue that any of those requirements were not met. Rather, he argued that the trustee was to blame for the mistake in not identifying him as the proper party, and should have done so before the statute of limitations expired. However, the BAP held that even if the trustee had mistakenly identified the proper party, the focus of the inquiry is what the defendant knew or should have known during the Rule 4(m) period, not what the plaintiff knew or should have known.

Next, the court affirmed the bankruptcy court's grant of summary judgment in favor of the trustee on the preference claims. The defendant asserted that the settlement payment was not avoidable because he established the contemporaneous exchange and ordinary course of business defenses.

The BAP rejected the defenses. The critical inquiry in determining a contemporary exchange for new value is whether the parties intended it as a contemporaneous exchange. Here, the debtor was not even a party to the settlement agreement. Moreover, the exchange – which by its terms would occur at least 15 days after payment – was not contemporaneous.

The BAP further rejected the ordinary course of business defense, which requires a showing of consistency between the transfer at issue and other transfers between the parties. Defendant argued that because the “form sales contract” contained an arbitration clause, the use of arbitration to resolve any dispute must clearly have been within the debtor’s ordinary course of business. The BAP rejected this argument for a number of reasons, but primarily relied on the insufficiency of evidence that the debtor routinely paid settlement payments on behalf of third-parties in its ordinary course of business.

***Obligation To Fund Retiree Benefits Contained In CBA May Survive Rejection Of CBA Depending On Terms Of Modification Under Section 1114***

In *In re Patriot Coal Corp.*, 13-6031 (8th Cir. BAP), the court held that a collective bargaining agreement could be rejected pursuant to Section 1113, but the obligation to fund certain retiree benefits provided for in that CBA could nevertheless survive pursuant to Section 1114 depending on whether the parties formally modified the terms of the CBA with court approval. Despite rejection of the CBA, a formerly affiliated (and

nondebtor) entity remained likewise obligated to pay the debtor’s retiree benefits through a separate pre-petition assumption agreement with the debtor.

Rejection of a CBA under Section 1113 results in a complete abrogation of the CBA, including the debtor’s obligation to fund its retirees’ benefits. However, under Section 1114(e)(1), the debtor is still required to “timely pay and shall not modify any retiree benefits, except that—the court, on motion of the [debtor] or [union] . . . may order modification of such payments . . .” Since Section 1114 begins with “[n]otwithstanding any other provisions of this title” – clearly including Section 1113 – the BAP reasoned that under the plain statutory language, a CBA could be rejected but the debtor would still be required to timely pay retiree benefits contained in the rejected agreement.

In this case, the debtor entity entered into a prepetition “me too” collective bargaining agreement with the union that specifically incorporated an article of the 2011 National Bituminous Coal Wage Agreement, which required provision of health and other benefits for retirees.

Additionally, a related but non-debtor entity entered into a prepetition acknowledgement and asset agreement with the union whereby it agreed to be “primarily obligated” to pay the benefits of “assumed retirees”. That agreement stated that the non-debtor, related party, was not a party to the CBA, nor did it have a labor relationship with the union. Nonetheless, the union could file a direct action requiring the related party to pay its obligations under the acknowledgment agreement. The related party also entered into a prepetition liabilities

assumption agreement with the debtor to consummate and define those obligations.

In its chapter 11 bankruptcy, the debtor filed a motion to reject the CBA and modify certain retiree benefits. The modification motion, however, expressly preserved benefits for certain “assumed retirees.” The bankruptcy court granted the motion. Additionally, the bankruptcy court held that all liabilities remained with the debtor, with the non-debtor, related entity simply having the obligation to the debtor to fund those liabilities. The debtor appealed, arguing the non-debtor, related entity remained the primary obligor as to the union as the Section 1114 motion did not seek modification the benefits for the class of assumed retirees.

The BAP did not determine which party was “primarily” liable as it was clear that both remained liable. In this case, neither the debtor nor the union requested such a modification as to the assumed retirees. Notwithstanding the rejection of the CBA, the obligation to timely pay certain retiree benefits remained unmodified and intact under Section 1114. That obligation existed as to the debtor and the related party as the acknowledgement with the union and related assumption agreements remained effective against the related party.

***Petitioning Creditor Entitled To Recover Only Fees And Expenses Actually and Necessarily Incurred; Reimbursement For Salaried Employees By The Petitioning Creditor Disallowed***

In *In re HovdeBray Enterprises*, Bky Case No. 10-61196 (Bankr. D. Minn., Sept. 17, 2013), the court approved expenses filed by the petitioning creditor’s attorney for

compensation and reimbursement since they were actually and necessarily incurred in filing the involuntary petition.

The creditor brought an unopposed involuntary Chapter 7 petition against the debtor and took the lead in convincing other creditors to join. After the court granted the petition, the debtor prepared the schedules, statement of financial affairs, and other required documents.

The petitioning creditor advised the trustee of a potential preference claim, which the trustee successfully pursued and recovered. The preference recovery became the largest asset of the bankruptcy estate.

The petitioning creditor sought allowance of compensation for attorneys’ fees in the amount of \$7,380 (\$4,320 of which was incurred through the date of the order for relief), the filing fee of \$299, and reimbursement of approximately \$3,880 in expenses as a petitioning creditor. The creditor who lost the preference litigation objected.

The bankruptcy court sustained the objection in part, determining that under Sections 503(b)(3)(A) and 503(b)(4), the creditor was entitled to reimbursement for its “actual, necessary expenses” incurred in filing the petition, including reasonable compensation for professional services rendered, the filing fee, and accompanying expenses incurred by its attorney or accountant.

The court disallowed the petitioning creditor’s \$3,880 expense claim on the basis that it was outside the scope of Section 503(b)(3)(A) and the creditor provided insufficient supporting detail. Further, all of the work claimed was

performed by the petitioning creditor's salaried employees so there was no out-of-pocket expense incurred.

Finally, with regard to the requested attorneys' fees, the court held that the fees appeared to be reasonable but limited the reimbursement claim to \$4,005, which represented the services performed in "preparing and filing the involuntary petition, contacting other creditors to join in the petition, legal and factual research regarding the grounds for filing the case," and other services through the date of the order for relief.

The bankruptcy court disallowed those fees incurred after the order for relief because no prior court approval was sought, and there were no extraordinary or unusual circumstances surrounding the case. The involuntary petition was uncontested, the debtor retained its own counsel – who then prepared schedules and other documents – and the trustee actively undertook its duties and did not seek to employ the petitioning creditor's attorney on behalf of the estate.

***Nationally Chartered Bank May Use State Statutory Non-Judicial Foreclosure Remedies Without Receiving "Authorization" To Do Business In The State Through Registration With A Formal State Agency***

In five consolidated cases captioned, in part, *JPMorgan Chase Bank, N.A. v. Johnson*, No. 12-2370 (8th Cir., July 9, 2013), the court held that a national banking association chartered by the OCC, but unregistered with the secretary of state and the state regulators, was nonetheless entitled to employ statutory

non-judicial foreclosure remedies.

In each of the consolidated cases, the foreclosing lender attempted to avail itself of state statutes entitling mortgage companies authorized to conduct business in the state to foreclose on defaulted mortgages without initiating judicial proceedings. The borrowers claimed that the lender did not complete state specific registration procedures necessary to obtain "authorization" to conduct business in the state. In all five cases, the district court ruled the lender, a national bank, had standing to conduct non-judicial foreclosure.

The Eighth Circuit affirmed, reasoning that registration with either the secretary of state or the state bank regulators was not plainly stated as the only method by which a lender could be "authorized to do business" in the state. The court highlighted a related chapter of the statute which allowed a mortgage company authorized to conduct business under the laws of the United States to serve as a trustee in a non-judicial foreclosure proceeding. Since a related provision required authorization to do business in the state for mortgage companies to avail themselves of any "procedures under the chapter," the court reasoned that authorization to do business in the state could be accomplished under federal law.

Further, the court held that the provisions of the National Bank Act specifically authorized the lender to conduct business in each state. The court stated that under the NBA, the lender – subject to OCC regulation – could conduct mortgage lending notwithstanding any contrary state law. Further, because the power to foreclose was incidental to the express

power to make mortgage loans, the lender by virtue of federal law could avail itself of state statutory non-judicial foreclosure remedies.

***Post-Petition Judgment Registration Survives Avoidance Action; Mortgagee that Slept on its Rights Lacks Standing to Assert Stay Violation***

In *Seaver v. New Buffalo Auto Sales, LLC* (*In re: Dennis E. Hecker*), No. 13-6005 (8th Cir. BAP, Aug. 8, 2013), the court held that neither the trustee nor a senior mortgagee could recover from a judgment creditor who registered and recovered upon a judgment lien on debtor's property post-petition.

The debtor owned a home referred to as Northridge, which was registered as Torrens property, when he filed his Chapter 7 petition in June 2009. Northridge was encumbered by a first mortgage of \$250,000. It was also encumbered by second and third mortgages totaling \$900,000, held by the same mortgagee. In addition, Northridge had county and federal tax liens of more than \$2.6 million against it. In total, Northridge was overencumbered by at least \$2 million.

Two parties obtained judgments against the debtor pre-petition, but prior to the bankruptcy did not register their judgments against Northridge's certificate of title to create valid liens.

The first mortgagee obtained relief from the automatic stay to foreclose its mortgage, and completed the sale on January 19, 2010 by credit bidding and obtaining the property, subject to redemption rights, for \$213,263. The first

mortgage did not serve the debtor with the sale notice, but he had actual knowledge of it. The first mortgagee mailed notice of the sale to the nominee for the second mortgage on January 8, 2010.

After the foreclosure sale, the trustee held the debtor's right to redeem, scheduled to expire on July 19, 2013, but he did not monitor the foreclosure. In February 2010, the second mortgagee obtained relief from the automatic stay. However, it did not foreclose its second and third mortgages.

In April 2010, the judgment creditors registered their judgments to perfect liens against Northridge. They did not first obtain relief from the automatic stay.

The second mortgagee, the tax-lien holders, and the trustee all failed or chose not to redeem from the first mortgagee. One of the judgment creditors redeemed and thereafter sold Northridge to a third-party for more than \$618,000.

On July 23, 2010, the trustee filed a notice of the bankruptcy on Northridge's certificate of title, and, three days later, he filed an adversary proceeding to avoid the post-petition registration of the judgment liens.

In March 2011, the second mortgagee published notice of a planned foreclosure sale. The judgment creditors obtained an injunction in state court, arguing the second and third mortgages had been foreclosed. The second mortgagee filed a petition, naming the judgment creditors as defendants, alleging the foreclosure was invalid and stating that the judgment creditors had no interest in Northridge. The second mortgagee then intervened in

the adversary proceeding.

The bankruptcy court held that even if the registrations were avoidable under Section 549, relief under Section 550 would not restore the estate to its pre-transfer condition but rather would result in a windfall to the estate because the estate's property interest in overencumbered Northridge, limited primarily at that time to the owner's right of redemption, had no value, and the registration of the judgments resulted in no loss to the estate.

The bankruptcy court held that judgment liens created by registration of the judgments did not violate the automatic stay and questioned whether the second mortgagee even had standing to raise the issue.

The BAP affirmed the rulings. With regard to the trustee's appeal, the BAP reasoned that had the trustee redeemed, the property would have still been subject to numerous encumbrances that would have wiped out any equity in the property. Accordingly, the trustee's redemption right held no value and the estate was not harmed by registration of the judgments. Thus, the trustee was not entitled to any relief.

The BAP also ruled that in order to determine whether the foreclosure sale was validly conducted required joinder of the first mortgagee, which did not occur. Accordingly, the issue was not properly before the BAP. With regard to whether the automatic stay was violated, the BAP concluded that technically it was, but that the second mortgagee did not have standing because it was not an aggrieved party as the true cause of its harm was its own failure to redeem from the

foreclosure.

***Appeal Dismissed for Failure to Comply with the Federal Rules of Bankruptcy Procedure***

In *In re Anderson*, 13-1366 (D. Minn.), the court dismissed an appeal from an order of the bankruptcy court. The appellant failed to pay the appeal fee or file for *in forma pauperis* status, despite notification from the bankruptcy court of the missing fee and a period of time during which to pay the fee or file a petition to proceed *in forma pauperis*. The district court stated that if an appellant violates one of the federal rules of bankruptcy procedure, the district court may dismiss the appeal. The court then dismissed the case for failure to comply with the bankruptcy rules, without further opportunity to cure the failure.

The district court noted that dismissal was particularly appropriate in this case due to the appellant's ongoing abuse of the bankruptcy process and lack of good faith. Specifically, the appellant, acting as one of the petitioning creditors, attempted to file an involuntary bankruptcy case against himself.